

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

77-6090

To be argued by
WILLIAM G. BALLAINE

United States Court of Appeals
FOR THE SECOND CIRCUIT

Docket No. 77-6090

THE CONDE NAST PUBLICATIONS INC.,

*Plaintiff-Appellee and
Cross-Appellant,*

—against—

UNITED STATES OF AMERICA,

*Defendant-Appellant and
Cross-Appellee.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

**BRIEF OF DEFENDANT-APPELLANT AND
CROSS-APPELLEE**

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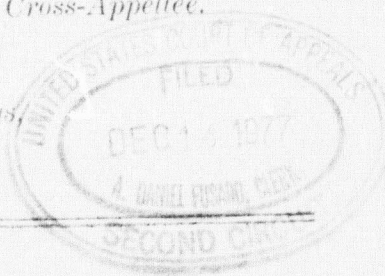


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**BRIEF OF DEFENDANT-APPELLANT AND
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Issues Presented

As is indicated in the main brief of The Conde Nast Publications Inc. ("taxpayer"),* the two issues presented for review are:

1. Did the District Court err in holding that certain royalty payments received by taxpayer from The Butterick Company, Inc. for 1967 and 1968 were receipts from the sale of a capital asset held for more than six months and entitled to capital gains treatment pursuant to 26 U.S.C. § 1201? [Raised by Government's appeal].

2. Did the District Court err in holding that, even though taxpayer had sold a capital asset, the portion of

* Pursuant to an agreement of the parties, taxpayer filed its main brief first.

royalty payments attributable to The Butterick Company, Inc.'s sale of Vogue dress patterns did not qualify for capital gains treatment? [Raised by taxpayer's cross-appeal].

Statement of the Case

The United States of America (the "Government") appeals and taxpayer cross-appeals from the judgment and amended judgment entered in the United States District Court for the Southern District of New York. JA—161-62.* This action had been commenced by taxpayer pursuant to 28 U.S.C. § 1346(a)(1) for purposes of obtaining a refund of federal income taxes for the years 1967 and 1968 in the amounts of \$36,913.00 and \$45,865.00, respectively. JA—4-6. Taxpayer's claim is based upon the contention that royalty payments received during the two tax years were entitled to capital gains treatment under Section 1201 of the Internal Revenue Code of 1954, as amended (the "Code"), 26 U.S.C. § 1201. JA—4-12.

Statement of Facts

The Vogue trade-mark and trade name** is presently registered by taxpayer throughout the world and has been for most of this century. JA—18. The name is recognized as a valuable property right. *See Conde Nast Publications, Inc. v. Vogue School of Fashion Modelling, Inc.*, 105 F. Supp. 325, 328 (S.D.N.Y. 1952).

Prior to 1961, taxpayer had engaged principally in the business of publishing Vogue Magazine and other magazines concerning ladies' fashions. However, taxpayer also had designed, manufactured and sold dress patterns

* "JA—" refers to the Joint Appendix.

** Unless otherwise indicated, the terms trade-mark and trade name will be used interchangeably in this brief.

and published related promotional materials. These patterns and promotional materials bore the same Vogue trade name used by taxpayer in its publishing business. JA—18, 25.

On January 20, 1961, taxpayer sold its entire dress pattern business to The Butterick Company, Inc. ("Butterick"), a company already in the business of designing, manufacturing and selling dress patterns. Prior to the sale, Vogue patterns had been sold by taxpayer in a high style and price line, but the business had been operating at a financial loss for a number of years. Butterick had been selling its patterns in the low priced field, and it too had been operating at a financial loss for a number of years. JA—25.

The sale agreement between the parties provided for the "sale" and "assignment" of much of taxpayer's dress pattern business, including machinery and equipment, accounts, contracts, inventories, subscribers' lists, and work in process. JA—26-61. The agreement also called for the execution of a "license and royalty agreement" authorizing Butterick's exclusive use of the Vogue name but solely in connection with its design, manufacture and sale of patterns and related promotional materials. JA—26, 63-74. As partial consideration for the sale, the sale agreement stated that taxpayer was to receive a minimum of 15,000 shares of Butterick's common stock, which had an agreed value of \$225,000. These shares were represented to be at least 13.6% of all issued and outstanding common stock of Butterick. JA—37-39, 50-51.

The separate license and royalty agreement was formally executed by the parties on March 31, 1961. JA—78-94. In this agreement, taxpayer granted to Butterick the exclusive license to use the Vogue name in its pattern business, "but for no other purpose." JA—81. The limited grant contained the following additional restrictions:

1. Butterick promised to use the Vogue name only on patterns and promotional material that were of the same "high standards and quality" as the patterns and promotional materials previously made and sold by taxpayer. In the event Butterick used the Vogue name in association with another name, the patterns and promotional material had to be "at least equal to the standards and quality" of the patterns and promotional materials previously made and sold by Butterick. JA—81.

2. Taxpayer had the right to examine during normal business hours all patterns and promotional materials designed, manufactured and sold by Butterick bearing the Vogue trade name to insure that the requisite standards and quality were being met. JA—81-82.

3. Butterick agreed not to engage in or authorize any undignified methods of advertising, publicizing, marketing, promoting or distributing the patterns and promotional material bearing the Vogue name. JA—82.

4. In the event of a trademark infringement involving use of the Vogue name in the design, manufacture or sale of dress patterns or promotional material, Butterick had the obligation to notify taxpayer of the infringement. At such time, taxpayer, not Butterick, would take "appropriate action" to cause the infringement to cease. If taxpayer did not thereafter institute and prosecute such an action, however, Butterick then had the authority to institute an action, but in taxpayer's name. JA—82.

5. Taxpayer had absolute authority to prohibit Butterick from assigning its rights under the license unless the assignment was made to an assignee that acquired Butterick's entire pattern business and agreed in writing to perform all of Butterick's obligations under the license. More-

over, even if these conditions were met, taxpayer still had the right to withhold consent, unless it did so "unreasonably," and taxpayer had the unfettered right to refuse consent if the prospective assignee was engaged in the publication of a magazine devoted primarily to women's and girl's fashions at a time when taxpayer was still engaged in that same business. JA—87. Finally, Butterick only had the power to sub-license its rights under the license to a corporation wholly owned by Butterick and only so long that corporation remained wholly owned by Butterick. JA—87.

6. Butterick was required to pay taxpayer annual royalties for the Vogue name. The royalties were a percentage of Butterick's gross receipts from the sale of its pattern, including, but not limited to, Vogue patterns. JA—19, 83-84.

7. Butterick's rights were to terminate in the event (i) Butterick failed to pay royalties due under the license; (ii) Butterick was adjudicated a bankrupt; (iii) Butterick ceased its business of selling dress patterns; (iv) a majority of Butterick's voting stock became owned by anyone engaged in the publication of a women's and girls' fashion magazine; (v) Butterick executed an assignment or sub-license not authorized under the license agreement; or (vi) Butterick defaulted in payment of certain sums due under the sale agreement. JA—85-86. After twelve years of the license, taxpayer also was to have the authority to cancel the license unless it received a minimum annual royalty payment of \$1,000. JA—88-89. Upon termination of the license, all rights to the licensed Vogue name were to revert to taxpayer. JA—88.

In addition to these terms and restrictions, the license agreement made clear that all registrations of the Vogue

trade-mark were to remain in taxpayer's name. JA—85. It also indicated that taxpayer retained the power to assign the right to use the Vogue name in conjunction with the sale of dress patterns or promotional material, but that any such assignment would be subject to the license. JA—89.

Under the license taxpayer agreed to provide, without charge, minimum "editorial" space in its magazines in order to feature patterns designed, manufactured and sold by Butterick. JA—82-83. Furthermore, the license contained the express agreement that the editorial staff of taxpayer's magazines would advise and assist Butterick concerning fashion trends and fashion information. JA—83. Thus, when taxpayer publicly announced the sale of its pattern business to Butterick, taxpayer declared that "the existing liaison with the Conde Nast editorial and art departments, as well as its fashion publication, will be maintained." JA—19.

In 1967, in connection with American Can Company's purchase of all of Butterick's assets and business, taxpayer and Butterick signed a new license agreement. JA—20, 95-120. The agreement was dated November 10, 1967, but made effective as of March 31, 1961. JA—20, 95-96. This new agreement strengthened requirements relating to the minimum standards of quality of Butterick's patterns and promotional materials. It also granted taxpayer new rights to inspect all phases of Butterick's operations. Compare JA—81-82 with JA—100-02. In addition, the new agreement obligated Butterick to pay minimum annual royalties of \$25,000 beginning in 1973, rather than the \$1,000 annual minimum specified in the original license agreement. JA—72, 110. The 1967 agreement retained all of the other restrictions and conditions set forth in the original agreement. See JA—20. At the conclusion of the new agreement, taxpayer formally consented to Butterick's assignment of all its rights under the two license agreements to American Can Company. JA—112.

Pursuant to the License,* taxpayer devoted "editorial" space each year in its magazines, without cost, to dress patterns manufactured and sold by Butterick. Vogue Magazine generally devoted twenty pages annually to Butterick's patterns. JA—20. It cost taxpayer more than \$42,000 in 1967 and more than \$49,000 in 1968 to produce this free "editorial" space for Butterick. JA—20-21.

Although it appears the parties had no major disputes concerning the License, the record does reflect a "perennial" difficulty taxpayer had with Butterick concerning use of the Vogue logo on Vogue Pattern Book International covers. See JA—121-132. Thus, in late 1969, taxpayer insisted that Butterick change its logo so that the words "Pattern Book" would appear as prominently as "Vogue", taxpayer having been disturbed that the public was being confused by publications in which the word "Pattern" was subdued. JA—121-25, 130-32. Taxpayer also had difficulties with a subsidiary of Butterick concerning the latter's emphasis of the name "Vogue", rather than "Vogue Pattern" in promotional features. JA—125-29.

At least through 1968, taxpayer treated all royalty payments received under the License as ordinary income for federal income tax purposes. Butterick deducted these same royalty payments as part of Butterick's cost of goods sold. JA—22.

For tax year 1967, taxpayer received total royalty payments of \$160,492.00. Approximately 53% of Butterick's total net sales during that year had been attributable to Vogue pattern sales. For tax year 1968, taxpayer received \$181,286.00 in royalties under the License. Approximately 52% of Butterick's total net sales during

* The 1961 license agreement and the 1967 agreement hereinafter will be referred to collectively as the "License".

1968 had been attributable to Vogue pattern sales. JA—20, 157-58. On January 15, 1973, some twelve year after signing the first license agreement, taxpayer filed administrative refund claims for 1967 and 1968 claiming that the royalties received in those year were not ordinary income at all, but rather capital gains resulting from the sale of a capital asset. JA—7-12, 22-23.

Proceedings Below

Taxpayer's refund action was submitted on stipulated facts and documents to the United States District Court for the Southern District of New York, by the Hon. John M. Cannella, for disposition on the merits. JA—18-134, 135. The District Court thereafter rendered an opinion (JA—135-156) in which it held that for tax purposes taxpayer had sold, not licensed, the name Vogue for use by Butterick in connection with the dress pattern business. JA—153-54. The District Court reached this result after analyzing decisions by the Courts of Appeal for the Fourth, Fifth, Eighth, Ninth and Tenth Circuit in cases involving the transfer of Dairy Queens franchises. JA—143-51.* The District Court added that its conclusion

* These cases will be referred to collectively as the "Dairy Queen cases." The full citations to these cases, broken down by circuit, are as follows:

¶ Fourth Circuit Court of Appeals—

Gowdey's Estate v. Commissioner, 20 CCH Tax Ct. Mem. 555 (1961), *rev'd in part*, 307 F.2d 816 (4th Cir. 1962).

¶ Fifth Circuit Court of Appeals—

Moberg v. Commissioner, 35 T.C. 773 (1961), *rev'd and remanded*, 305 F.2d 800 (5th Cir. 1962), *on remand*, 22 CCH Tax Ct. Mem. 1483 (1963), *aff'd*, 365 F.2d 337 (5th Cir. 1966).

¶ Eighth Circuit Court of Appeals—

United States v. Wernentin, 354 F.2d 757 (8th Cir. 1965), *rev'g in part*, 218 F. Supp. 465 (S. D. Iowa 1963).

[Footnote continued on following page]

was consistent with this Court's decision in *Cory v. Commissioner*, 230 F.2d 941 (2d Cir.), *cert. denied*, 352 U.S. 828 (1956). JA—152-54.

The District Court further held, however, that capital gains treatment should be accorded only on those royalty payments received by taxpayer which were not contingent upon Butterick's sale of patterns bearing the Vogue name. JA—154-56. Since the record did not reflect the necessary breakdown on royalty payments, the parties thereafter supplemented the record, indicating the royalty amounts received by the taxpayer in each year that were not attributable to Vogue pattern sales. JA—156-58. Judgment then was signed and entered granting taxpayer a partial refund based upon the parties' submission. JA—159.*

ARGUMENT

Taxpayer's Limited Transfer Of The Vogue Name Was A License, Precluding Capital Gains Treatment On Any Royalty Payments

Taxpayer's claim to capital gains treatment on all royalty payments received from Butterick in 1967 and 1968 is predicated on its contention that the payments

¶ Ninth Circuit Court of Appeals—

Moberg v. Commissioner, 35 T.C. 773 (1961), *rev'd in part and remanded*, 310 F. 2d 782 (9th Cir. 1962).

¶ Tenth Circuit Court of Appeals—

Dairy Queen of Oklahoma, Inc. v. Commissioner, 26 T. C. 61 (1956), *rev'd and remanded*, 250 F.2d 503 (10th Cir. 1957), *on remand*, 18 CCH Tax Ct. Mem. 322 (1959).

* The original judgment was amended so that if taxpayer prevails on appeal, it will clearly be entitled to all interest due under the Code. See JA—160.

constituted consideration for the "sale or exchange of a capital asset" held by taxpayer. See 26 U.S.C. §§ 1201, 1221-22. Having convinced the District Court that it had "sold" to Butterick a limited use of the Vogue name, taxpayer now argues that the District Court's holding should not be disturbed unless it is "clearly erroneous." Txp. Br. 7. This Court has acknowledged, however, that

whether a sale or exchange occurred involves "the legal characterization, for federal income tax purposes, of the transactions between the parties" which is "not a question of fact, but rather one of law" fully reviewable by us on appeal. *Union Planters National Bank of Memphis v. United States*, 426 F.2d 115, 117 (6th Cir.), cert. denied, 400 U.S. 827, 91 S. Ct. 53, 27 L.Ed. 2d 56 (1970).

Handelman v. Commissioner, 509 F.2d 1067, 1070 (2d Cir. 1975). Moreover, the District Court's decision was based entirely on stipulated facts and documents. In such circumstances, this Court is not bound by the "clearly erroneous" standard. This Court may, instead, exercise its discretion and review the documentary evidence *de novo*. See *Novelty Textile Mills, Inc. v. Joan Fabrics Corp.*, 558 F.2d 1090, 1093 (2d Cir. 1977); *Jacobson & Co., Inc. v. Armstrong Cork Co.*, 548 F.2d 438, 443 (2d Cir. 1977); cf. *Estate of Neugass v. Commissioner*, 555 F.2d 322, 326 (2d Cir. 1977).^{*} Although never expressly stated, full review seems to have been given by appellate courts in other circuits when confronted with the issue presented here.^{**} The United States contends that a

^{*} But see also *State of New York v. Nuclear Regulatory Commission*, 550 F.2d 745, 151-52 n.6 (2d Cir. 1977) where Judge Waterman criticizes broader review.

^{**} A *de novo* review seems to have been given by all of the circuit courts of appeal in the Dairy Queen cases. See pp. 8-9 *supra*, citing these cases in full. See also *Leisure Dynamics, Inc. v. Commissioner*, 494 F.2d 1340 (8th Cir. 1974), rev'g, 32 CCH Tax Ct. Mem. 159 (1973).

review of the stipulated facts and documents in this action reveals that the taxpayer merely licensed to Butterick a limited right to use the valuable "Vogue" trade name, precluding entirely taxpayer's claim to capital gains treatment.

In order to qualify its transaction as a sale for capital gains purposes, the taxpayer must have transferred all substantial rights to the Vogue name. If the taxpayer retained a substantial right in the transferred asset or continued to participate in the transferee's business, the transfer is only a license. *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d at 1343-44 and n.4; see S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969), reprinted in [1969] U.S. Code Cong. & Ad. News 2027, 2242.* The inquiry should be aimed at determining the value of the transferor's retained rights as of the date of transfer. See *Allied Chemical Corp. v. United States*, 370 F.2d 697, 699 (2d Cir. 1967), *aff'g*, 66-1 USTC ¶ 9212 (S.D.N.Y. 1966). The Government contends that the rights and interests retained by taxpayer at the time of transfer demonstrate that it merely licensed to Butterick a limited right to use the Vogue name.

* Taxpayer's brief states the standard too restrictively, claiming that the transferor must retain *and* exercise an active and continuing interest in the trade-mark *and* in transferee's business. Txp. Br. 7-8. Regardless of whether the transferor exercises an active and continuing operational interest in the transferee's business, a license rather than a sale exists where the transferor retains substantial rights to *or* continuing interests in the transferred trade name. *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d at 1343-44 and n.4; see S. Rep. No. 91-552, *supra*, U.S. Code Cong. & Ad. News at 2242; *cf.* *Allied Chemical Corp. v. United States*, *supra*, 370 F.2d at 699.

A. A "License" Granting Limited Use of A Trade Name, Subject to Quality Controls and Royalties Based On Use of the Name, Cannot Qualify As A Sale Entitled to Capital Gains Treatment

Taxpayer transferred to Butterick only one of many valuable uses of the Vogue trade name, making the transfer contingent upon payment of wholly indeterminable royalties based in part on Butterick's use of the transferred name. The transfer was effectuated pursuant to an agreement which the parties termed a "license and royalty agreement" and which contained specific quality control restrictions concerning Butterick's use. These terms and restrictions, standing alone, defeat taxpayer's claim that it "sold" the Vogue name for capital gains purposes.

The starting point for the Government's position is this Court's decision in *Cory v. Commissioner, supra*, 230 F.2d 941, a decision which the District Court mistakenly read as supporting taxpayer's claim.*

In *Cory*, the taxpayer had transferred to a publisher the exclusive right to publish a book in all forms in the United States and Canada, but retained the remaining foreign publishing rights and all motion picture, drama and serial rights. As consideration, the taxpayer received royalty payments based upon a percentage of all books sold by the publisher. This Court concluded that the copyright transfer was a mere license and not entitled

* The District Court incorrectly read *Cory* as concluding that the transfer of rights to publish a work in the United States and Canada was a sale (JA—152), whereas, in fact, this Court had concluded that the transfer was a mere license. Furthermore, the District Court quoted dictum from *Cory* rather than this Court's holding. The *Cory* holding is squarely at odds with the District Court's decision in taxpayer's favor. See p. 13 *infra*.

to capital gains treatment.* The holding of this Court was:

We do not now decide that a transfer by a citizen of but a part of the bundle [of rights] for a definite sum, or a transfer of the whole for an indeterminate sum, is a sale for purposes of Section 117 [of the Internal Revenue Code of 1939, as amended]. We do hold that when, as here, the transfer is both (1) a transfer of a part of the cluster of rights and (2) for an amount wholly indeterminable at the time of the transfer, no such sale occurs. [footnote omitted]

Cory v. Commissioner, supra, 230 F.2d at 944.**

The import of *Cory* is clear. If a taxpayer transfers a "distinct right" for a "definite sum", it is not foreclosed by *Cory* from claiming a sale for tax purposes. If a taxpayer, however, transfers a "distinct right", but *not all rights*, and does so for an "amount wholly indeterminable at the time of transfer", the transaction will not qualify as a sale for capital gains purposes. This holding cannot be squared with the District Court's conclusion that taxpayer's limited transfer effected a sale for capital gains purposes.***

* Under Section 1221(3) of the Code, 26 U.S.C. § 1221(3), most copyright transfers are now excluded from capital gains treatment.

** Taxpayer cites *Commissioner v. Hopkins*, 126 F.2d 406 (2d Cir. 1942) for the proposition that royalty payments do not preclude a sale. Txp. Br. 8. *Hopkinson*, however, was cited and distinguished in *Cory* on the ground that *Hopkinson* involved the transfer of an "entire bundle" of rights. *Cory v. Commissioner, supra*, 230 F.2d at 944, n.5.

*** In Revenue Ruling 60-226, 1960-1 Cum. Bull. 26, the IRS adopted a position which may appear to conflict with *Cory*, stating that the grant of a right to exploit a copyrighted work in a medium of publication constitutes a sale even though the consideration is measured by the transferee's success in exploiting

[Footnote continued on following page]

Reference to principles of law governing trade-marks and trade names demonstrates that the application of *Cory* yields the correct result in the present case. A trade-mark or name is an intangible asset associated with the good will developed by a business. Under the Lanham Act, 15 U.S.C. §§ 1051 *et seq.*, the owner of a trade-mark may register his mark with the Patent office and thereby claim a variety of legal benefits conferred by that statute. The Lanham Act is designed not only to protect the value of the registered mark to the owner, but also to protect the public from being misled by falsely marked goods. *E.g.*, *Franchised Stores of New York, Inc. v. Winter*, 394 F.2d 664, 668 (2d Cir. 1968).

the work. This 1960 ruling was published in light of Revenue Ruling 58-353, 1958-2 Cum. Bull. 408, concerning patent transfers. In the earlier patent ruling, the IRS had abandoned its contention that the retention of royalty interests alone precluded capital gains treatment. Revenue Ruling 58-353 was responding in large part to the fact that Congress had enacted a statute providing that a patent could be "sold" even though payments were contingent on use of the transferred property. See 26 U. S. C. § 1235(a)(2). The 1958 patent ruling did not specifically state whether a transfer combining a limited use and royalties based on such use could qualify as a sale. Revenue Ruling 58-353 did state, however, that a patent transfer involving royalties still might fail to have "sufficient characteristics of a sale" and gave a "compare" citation to *Cory v. Commissioner*, *supra*, 230 F.2d 941.

Revenue Ruling 60-226 should not be read as contradicting the application of *Cory* to the present trade name transfer. Unlike with copyrights or patents, Congress has concluded in substance that the existence of royalty payments based upon use of a trade name *does* preclude capital gains treatment. See 26 U.S.C. § 1253(b)(2)(F) and (c). Moreover, like the earlier patent ruling, Revenue Ruling 60-226 states that transfers involving royalties may also involve the retention of *other* rights which preclude a sale, and cross-references to the cases cited in Revenue Ruling 58-353, including *Cory*. Thus, Revenue Ruling 60-226 may be read to preclude a sale where, as in *Cory*, the taxpayer transfers a limited right to use the intangible asset, *also* retains other *substantial* rights to the asset, and is paid by means of royalties based upon transferee's limited use.

The holder of a registered trade-mark and name may assign a distinct and separate portion of its business, together with the good will and mark associated with that business. 15 U.S.C. § 1060; 1 McCarthy, Trademarks and Unfair Competition § 18:6 (1973); Restatement of Torts 2d, Explanatory Notes § 756 (Tent. Draft No. 8, 1963). But an owner cannot sell its business, together with the good will and trade-mark, and still continue to use the mark in the same trade area on goods that are of the same general class or on goods likely to be associated by the public with a common source. 1 McCarthy, *supra*, § 18:6 at 617-18; Restatement of Torts 2d, *supra*, § 756; *cf. Acme Valve & Fittings Co. v. Wayne*, 386 F. Supp. 1162, 1165-66 (S.D. Tex. 1974) [grant of use of a name on bronze valves, but not all metal valves, "at best" a license].*

The strict law limiting the authority of an owner to assign its mark outright does not preclude the owner from making a limited transfer desired by simply granting a license. *See, e.g.*, 15 U.S.C. §§ 1055, 1127; *cf. Acme Valve & Fittings Co. v. Wayne*, *supra*, 386 F. Supp. at 1166. The license, however, must include adequate quality controls concerning the transferee's limited use of the name. 1 McCarthy, *supra*, § 18:14; *see, e.g., Dawn Donut Co., Inc. v. Hart's Food Stores, Inc.*, 267 F.2d 358, 366-67 (2d Cir. 1959).** Accordingly, licenses typically

* Thus, for example, the Restatement of Torts 2d, *supra* § 756, subsection f. at 142, states that if an owner of "X" mark used on toothpaste and shaving cream transfers only the toothpaste business, it is "questionable" whether the "X" mark can be assigned effectively.

** If the transferor grants a "naked" license (containing no quality control restrictions) or if the transferor fails to control the licensee's use of the name, the license will be found invalid, and the registered mark may even be cancelled. *See* 15 U.S.C. §§ 1064, 1127; *Franchised Stores of New York, Inc. v. Winter*, *supra*, 394 F.2d at 668-69; *Weight Watchers of Quebec Ltd. v. Weight Watchers International, Inc.*, 398 F. Supp. 1047, 1052-53 n. 21 (E.D.N.Y. 1975).

provide for minimum standards of quality and the right of the licensor to enter the licensee's premises for inspection purposes. *See, e.g.*, Restatement of Torts 2d, *supra* § 756A at 145-46. *Compare* JA—100-02.

Trade-mark law suggests, therefore, that taxpayer could not have effectively sold the Vogue mark outright to Butterick for use in the pattern business even if it had wanted to do so because Butterick and taxpayer thereafter used the Vogue name on goods likely to be associated with a common source. This close association is illustrated by taxpayer's persistent objections to Butterick's emphasis of the single name "Vogue" on the cover of one of Butterick's publications rather than the name "Vogue Pattern". JA—121-25, 130-32.* Taxpayer also objected to Butterick's use of the name "Vogue" rather than "Vogue Pattern" in pattern promotions featured in an Australian women's publication, JA—25-29; and in doing so, taxpayer specifically advised Butterick that if the Vogue name were used alone it would be confused by the public with Vogue Magazine. JA—126. Indeed, in finding that the License's restrictions on Butterick's use of the Vogue name were intended primarily to protect the value of the name as used by taxpayer (JA—142-43),** the District Court implicitly recognized

* Taxpayer's brief implies that taxpayer transferred only the "Vogue Pattern" name. Txp. Br. 8. The record, however, indicates otherwise. Taxpayer transferred the "Vogue" mark and name. JA—18-19, 79-81, 97-100, 117-20.

** Whether or not this finding should be reviewed under the "clearly erroneous" test (*see* p. 10 *supra*), the finding is irrelevant to deciding whether taxpayer sold or licensed use of the Vogue name. The critical issue should be whether taxpayer retained substantial rights in the transferred name, not why. *See Schmitt v. Commissioner*, 271 F.2d 301, 308 (9th Cir. 1959), *aff'd*, 30 T.C. 322 (1958); *Roob v. Commissioner*, 50 T.C. 891, 902 (1968).

that Butterick's use of the name would be associated by the public with taxpayer's retained use of the same name.*

Regardless of whether taxpayer *could* have successfully assigned the limited right of use to Butterick, however, it is obvious that taxpayer voluntarily chose the more certain path by granting a mere license. Taxpayer's choice is evidenced by the fact that it clearly structured the agreement as a "license" and specifically included comprehensive quality control restrictions.**

Our analysis demonstrates that the *Cory* rule and trade-mark principles may be jointly applied to reach

* Taxpayer's recent history of trade-mark litigation indicates the broad categories of goods and trade names which, in its view, the public would confuse with Vogue Magazine. For example, taxpayer challenged, albeit unsuccessfully, the right of a company to register the name "Country Vogues" in connection with ladies' wearing apparel, arguing that the public would confuse that name with taxpayer's use of "Vogue" in publishing. See *The Conde Nast Publications Inc. v. Miss Quality, Inc.*, 507 F. 2d 1404 (C.C.P.A. 1975). Taxpayer took a similar position with respect to that same company's earlier proposed registration of the name "Junior Vogues". See *The Conde Nast Publications Inc. v. Miss Quality, Inc.*, 170 U.S.P.Q. 364 (TT&A Bd. 1971). Taxpayer has succeeded in convincing courts that greeting cards, writing paper and envelopes bearing the name "Vogue" would be confused by the public with taxpayer's use of the name. *The Conde Nast Publications Inc. v. American Greetings Corp.*, 329 F. 2d 1012 (C.C.P.A. 1964); *The Conde Nast Publications Inc. v. American Greetings Corp.*, 153 U.S.P.Q. 83 (TT&A Bd. 1967). Taxpayer also has successfully contended that the name "Vogue School of Fashion Modelling" would be associated by the public with taxpayer's use of the Vogue name in publishing. *Conde Nast Publications Inc. v. Vogue School of Fashion Modelling, Inc.*, *supra*, 105 F. Supp. 325. Given its litigating history, it would be ironic for taxpayer to contend here that the name "Vogue," when used in the dress pattern business, would not be associated by the public with taxpayer's use of precisely the same trade name.

** The fact that the Vogue name remains registered in taxpayer's name offers even further proof, if such proof were needed, that taxpayer chose to grant only a license. See *infra* at 27.

the same result. Under *Cory*, the transfer of less than all rights to the intangible asset, when consideration is based on wholly indeterminate royalty payments, precludes a sale. Under trade-mark law, the transfer of less than all rights, at least in circumstances such as taxpayer's, strongly suggests a license; and the suggestion yields to certainty when the transferor structures his transfer as a license and includes specific quality control provisions. Since the present taxpayer's transaction fails both the test of *Cory* and the test of trade-mark law, there can be only one conclusion—taxpayer merely licensed to Butterick a limited use of the Vogue name for tax purposes.

Although the courts have not specifically applied either the *Cory* rule or pertinent trade-mark principles in tax cases such as this, the results reached in these cases are consistent with the Government's present position. The Dairy Queen cases are illustrative. The decisions reached in these cases are confusing and inconsistent. See, e.g., *United States v. Werentin*, *supra*, 354 F.2d at 764-66; S. Rep. 91-552, *supra* [1969] U.S. Code Cong. & Ad. News at 2242. But they bear one common feature. With perhaps one exception, the courts reviewing the Dairy Queen cases have declined to give capital gains treatment to indeterminate royalty payments received by the transferor; and thus these cases are not at odds with the *Cory* rule.

The Dairy Queen cases each involved the issue of whether capital gains treatment was available on consideration paid by a transferee in exchange for exclusive territorial rights granted under various types of Dairy Queen franchise agreements. These agreements all involved the transfer of the right to use Dairy Queen machines and the Dairy Queen name and the right to distribute the Dairy Queen product.

The Tax Court consistently held that the Dairy Queen agreements at issue were licenses, emphasizing the various quality control restrictions. It therefore refused to permit capital gains treatment on either the lump sum payments or the royalty payments provided for under these agreements. *Moberg v. Commissioner, supra*, 35 T.C. at 784-85; *Dairy Queen of Oklahoma, Inc. v. Commissioner, supra*, 26 T.C. at 70-71; *Gowdey's Estate v. Commissioner, supra*, 20 CCH Tax Ct. Mem. 555.* One of these agreements found by the Tax Court to reflect a mere license was the so-called ten paragraph agreement, which the District Court conceded contained restrictions similar to the restrictions found in taxpayer's License. JA—150.**

Unlike the Tax Court, the Fifth Circuit Court of Appeals held that the Dairy Queen agreements were sales, not licenses. *Moberg v. Commissioner, supra*, 305 F.2d 800, *rev'g*, 35 T.C. 773. But the court ultimately refused to give capital gains treatment on any indeterminate royalty payments provided for under the agreements. *Id.*, 305 F.2d 800, *on remand*, 22 CCH Tax Ct. Mem. 1483, *aff'd*, 365 F.2d 337. Similarly, the Fourth Circuit Court of Appeals concluded that the agreements under review reflected sales, yet refused to permit capital gains treatment on any indeterminate royalties. *Gowdey's Estate v. Commissioner, supra*, 307 F.2d 816.*** The Eighth Cir-

* The Tax Court did find that one agreement, which contained almost no restrictions of any kind, reflected a sale. *Moberg v. Commissioner, supra*, 35 T.C. at 778, 784.

** The District Court's analysis of the Dairy Queen cases totally ignored the Tax Court's position. Yet, Congress, in enacting Section 1253 of the Code, 26 U.S.C. § 1253, appears to have agreed with the Tax Court's conclusion. Under the circumstances, the Tax Court's view was entitled to serious weight.

*** Taxpayer's brief (Txp. Br. 12) distinguishes the fourth circuit's decision in *Gowdey's Estate* and the fifth circuit's decision in *Moberg* from taxpayer's situation, noting that in those

[Footnote continued on following page]

cuit Court of Appeals denied capital gains treatment entirely, although the stated ground was the conduct of the parties, not just the agreements themselves. *United States v. Werentin*, *supra*, 354 F.2d 757.

The Tenth Circuit Court of Appeals concluded, without qualification, that the Dairy Queen agreements reflected sales. *Dairy Queen of Oklahoma, Inc. v. Commissioner*, *supra*, 250 F.2d 503. However, the court was only concerned with the tax treatment applicable to the lump sum payments. The franchisor had voluntarily treated all indeterminate royalty payments as ordinary income. *Id.*, 250 F.2d at 505. Finally, the Ninth Circuit Court of Appeals determined that three of the agreements under review were licenses. As to the fourth agreement, however, the ninth circuit said that it agreed with the fifth circuit's decision finding a sale; the ninth circuit thus reversed the Tax Court's finding concerning this agreement and remanded for further proceedings. *Moberg v. Commissioner*, *supra*, 310 F.2d 782. Unlike the fifth circuit's decision, however, the ninth circuit gave no specific consideration to the tax treatment to be accorded royalty payments, as distinct from lump sum payments, and the proceedings on remand apparently are not reported. Accordingly, although the ninth circuit decision may be read as granting capital gains treatment on royalties, *see, e.g., United States v. Wernentin*, 354 F.2d at 765, it is not entirely clear whether that is the result

cases it was determined that the royalties were additional charges resembling a continuing interest and not part of the sales price. *See Gowdey's Estate v. Commissioner*, *supra*, 307 F.2d at 820; *Moberg v. Commissioner*, *supra*, 365 F.2d at 339. The explanation given by the courts, however, seems at odds with the conclusion that the transferor had not retained any substantial interest in the transferee's business. *See Note, Income Tax—Gains or Losses on Sales and Exchanges*, 80 Harv. L. Rev. 455, 457 (1966). In any event, the results reached in *Gowdey's Estate* and *Moberg* do not conflict with the *Cory* rule.

the ninth circuit reached. In any event, this is the only Dairy Queen case that even arguably authorized capital gains treatment on royalty payments.

The Government's present position also is in harmony with the results reached by courts construing trade name transfers outside the franchise agreement setting. In *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d 1340, for example, the Eighth Circuit Court of Appeals concluded, contrary to the Tax Court below, that the taxpayer had received a mere license of the use of a trade name in connection with its manufacture of dolls. The court emphasized that the transferor had retained use of the same name with respect to the production and distribution of film cartoons and that the value of the dolls was "inextricably bound" to the airing of cartoon strips by the transferor. *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d at 1345-47. The court's emphasis of the transferor's retained use of a transferred name seems to acknowledge some of the realities of trade-mark law discussed in this brief.*

In *Rose Marie Reed v. Commissioner*, 26 T.C. 622 (1956), *acquiesced*, 1956-2 Cum. Bull. 8, the Tax Court held that a taxpayer had sold its right to a trade name for use by a corporation in the swimwear industry. The court indicated, however, that taxpayer had parted with *all* existing rights to use of the trade name in the United

*The taxpayer's position in *Leisure Dynamics* was even stronger than the present taxpayer's. See *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 32 CCH Tax Ct. Mem. 159, setting forth the parties' agreement. There, the transaction, at the transferor's specific behest, was structured as a "sale" and the purchaser obtained the exclusive right to register the trade-marks transferred. See *infra* at 27. Moreover, the agreement contained only brief quality control provisions.

States.* *Id.*, 26 T.C. at 629, 633. Similarly, in *United States Mineral Products Co. v. Commissioner*, 52 T.C. 177 (1969), the Tax Court concluded that a trade name had been sold where the transfer embraced *all* substantial rights to use of the name in Canada. *Id.*, 52 T.C. at 188, 196. Thus, neither decision violates the *Cory* rule.

Finally, in *Seattle Brewing & Malting Co. v. Commissioner*, 6 T.C. 856 (1946), *aff'd*, 165 F.2d 216 (9th Cir. 1948) and the companion case of *Rainer Brewing Co. v. Commissioner*, 7 T.C. 162 (1946), *aff'd*, 165 F.2d 217 (9th Cir. 1948), the Tax Court considered a transaction in which the grantor had transferred use of its trade name on alcoholic beverages in a limited geographical area. The Tax Court concluded that the transfer constituted a sale, but *only* as of the time the grantee exercised an option that terminated its obligation to make periodic royalty payments. According to the Tax Court opinion, the parties had been in agreement that, prior to the exercise of this option, the arrangement had constituted a mere license. *Seattle Brewing & Malting Co. v. Commissioner, supra*, 6 T.C. at 867. Moreover, although the transferor in that case retained the right to use the trade name on alcoholic beverages, the opinion gives no indication whether the name had any value other than when associated with alcoholic beverages.**

In summary, the Government contends that the following terms and restrictions, standing alone, defeat taxpayer's claim to capital gains treatment: (1) taxpayer

* Moreover, in *Rose Marie Reid*, the transferee had actually registered as owner of the name. *Id.*, 26 T.C. at 629, 634. See *infra* at 27.

** According to the opinion, the transferor had been in the business of making alcoholic beverages. There is no indication that it had ever used its trade name on any other beverages or even that it intended to do so after transferring use of the name on alcoholic beverages to another corporation.

granted only a limited right to use the Vogue name, retaining all other valuable uses of the name; (2) as consideration, taxpayer was to be paid indeterminate royalties; (3) taxpayer structured its agreement as a "license"; and (4) taxpayer included specific quality control restrictions governing Butterick's limited use of the Vogue name. Our position flows from the confluence of this Court's holding in *Cory v. Commissioner*, *supra*, 230 F.2d 941 and principles of trade-mark law. Notwithstanding the marked inconsistency in many of the decisions rendered by courts in other circuits, the Government's present position is consistent with the pertinent results reached by these other courts. The Government's position also comports with Congress' view of the tax treatment that should be accorded in a trade name transfer, *see* 26 U.S.C. § 1253;* and, unlike taxpayer's position, it does no violence to the underlying capital gains treatment.** Accordingly, this Court should apply the lessons of *Cory* and pertinent trade-mark law and reject taxpayer's claim to capital gains treatment.

* Section 1253 of the Code only applies to transfers made after 1969. The section precludes capital gains treatment where there are quality control restrictions. 26 U.S.C. § 1253 (b) (2) (C). It also precludes such treatment where payments are contingent on use of the interest transferred and such payments are a "substantial element" under the agreement. 26 U.S.C. § 1253 (b) (2) (F). Proposed Treas. Reg. § 1.1253-2(d) (6), *reprinted in* 6 CCH 1977 Stand. Fed. Tax Rep. ¶ 4774U, states that where royalties are 50% of the estimated consideration, these payments constitute a "substantial element" under the agreement.

** *See Moberg v. Commissioner*, *supra*, 365 F.2d at 340; Note, 80 Harv. L. Rev. *supra* at 458-59.

B. The Aggregate of All Retained Rights and the Circumstances Surrounding the Transfer Demonstrate that Taxpayer's "License" Cannot Qualify As A Sale Entitled to Capital Gains Treatment

In the last section, the Government argued that under the joint application of *Cory* and trade-mark principles, there are four aspects of taxpayer's License which, standing alone, compel denial of capital gains treatment. However, this Court has often refrained from applying fixed rules and instead has applied the case-by-case practice of aggregating all of the rights retained by a transferor and viewing those rights in the light of surrounding circumstances in order to determine whether a license or sale has been made. *E.g.*, *Allied Chemical Corp. v. United States*, *supra*, 370 F.2d at 699-70. The result reached by applying this method here is the same—taxpayer's transaction still must be viewed as a mere license.

As previously discussed, the fact that taxpayer granted Butterick only a limited right to use the Vogue name, retaining all other valuable uses, constitutes a retained right weighing against taxpayer's claim of a sale. *Cory v. Commissioner*, *supra*, 230 F.2d 941; *cf. Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d 1340.* Similarly, taxpayer's quality control provisions constitute a right to

* Treas. Reg. § 1-1235-2(b)(1)(iii) precludes capital gains treatment where a patent holder transfers less than all valuable rights covered by the patent. Prior to promulgation of the regulation, most courts held that a field-of-use patent transfer did not, standing alone, preclude capital gains treatment. *Compare E. I. du Pont de Nemours & Co. v. United States*, 432 F. 2d 1052, 1057 (3d Cir. 1970) [and cases cited therein] with *Redler Conveyor Co. v. Commissioner*, 303 F. 2d 567 (1st Cir. 1962). This Court, however, had refrained from passing on this issue. *Allied Chemical Corp. v. United State*, *supra*, 370 F. 2d 697, *aff'g*, 66-1 USTC ¶ 9212.

the transferred name retained by taxpayer. *See, e.g., Dairy Queen of Oklahoma, Inc., supra*, 26 T.C. at 70-71; *Schmitt v. Commissioner, supra*, 30 T.C. at 332-34. Royalty payments based on use of the transferred name also reflect a retained right. *Cory v. Commissioner, supra*, 230 F.2d 941; *see Watkins v. United States*, 252 F.2d 722, 725 (2d Cir.), *cert. denied*, 357 U.S. 936 (1958).*

Although it was ignored by the District Court, taxpayer retained a substantial right to the transferred name as a result of its acquisition of almost 14% of Butterick's outstanding shares of common stock.** This stock interest

*Taxpayer emphasizes that an indefinite purchase price contingent on productivity of the assets transferred does not preclude a sale. Txp. Br. 8. However, the "longer the payments are spread out . . . the more the payments resemble a continuing interest." *Moberg v. Commissioner, supra*, 365 F. 2d at 340. Thus, royalty payments, coupled with other restrictions, may preclude a sale. *E.g., Cory v. Commissioner, supra*, 230 F. 2d 941.

In addition, taxpayer's payments do not even fall squarely within the rationale for permitting a sale notwithstanding a transferor's receipt of royalties. The rationale is that the parties lack facts sufficient to ascertain the value of the asset at the time of transfer and thus must resort to a royalties arrangement. *See, e.g., Ayrton Metal Co. v. Commissioner*, 299 F. 2d 741, 751-52 (2d Cir. 1962). Taxpayer's royalties, however, are based on the sale of *all* patterns, indicating that taxpayer was receiving payments reflecting an interest in Butterick's *total* business, not merely fair consideration for the value to Butterick of the Vogue name.

** In focusing on the Dairy Queen cases, the District Court overlooked significant aspects of taxpayer's transaction—such as its acquisition of stock—which simply were not involved in the Dairy Queen cases. The District Court also failed to note that franchising arrangements are far different from taxpayer's transaction. *See* Txp. Br. 8. Thus, for example, the loosely-framed quality control restrictions contained in the Dairy Queen agreements and the requirement that only Dairy Queen products be sold were critical provisions to Dairy Queen franchisors whose financial future was tied to the successful development of each new Dairy Queen franchise. Taxpayer, however,

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gave taxpayer an important voice in all of Butterick's pattern business affairs. See *Watkins v. United States*, *supra*, 252 F.2d at 725.

Taxpayer's retention of control over trade-mark infringement actions is another retained right to the transferred name which the District Court overlooked. Yet this Court has referred to the right to control prosecution of an infringement action as an "important" retained right. *Watkins v. United States*, *supra*, 252 F.2d at 725; cf. *Allied Chemical Corp. v. United States*, *supra*, 370 F.2d at 700.

The District Court (JA—150-51) discounted the significance of taxpayer's broad authority to restrict Butterick's right to assign or sub-license. However, this Court has observed that a provision prohibiting assignment except to a successor in business is "an important factor in evaluating the substantiality of the rights retained." *Allied Chemical Corp. v. United States*, *supra*, 370 F.2d at 700; see *Watkins v. United States*, *supra*, 252 F.2d at 725. Taxpayer's License includes this precise factor—taxpayer retained the absolute right to bar an assignment except to an assignee acquiring Butterick's *entire* pattern business, and even then taxpayer may "reasonably" refuse its consent.

Evidence that taxpayer granted only a license of the Vogue name also lies in the agreements themselves. The

need not have been particularly concerned with Butterick's method of bookkeeping, its choice of suppliers or other like restrictions because taxpayer was transferring a well-established business to a corporation which was well-known to taxpayer and already engaged in the same business. Nor did taxpayer have reason to limit the products Butterick sold since taxpayer's royalties were a percentage of all Butterick sales. Therefore, the absence of many of the Dairy Queen restrictions in taxpayer's License proves little in the present case.

sale agreement, the 1961 license agreement and the 1967 license agreement all were executed by knowledgeable businessmen, presumably well-versed in the meaning and effect of the documents signed. Given the sophistication of the parties and the careful drafting evident in each agreement, the parties' description of their agreement as a "license and royalties agreement" (JA—26), taxpayer's retention of the right to "assign" use of the Vogue name in the pattern industry, and the other provisions connoting a license (discussed *supra* at 15-18) are terms which may be accepted at face value here. See *Redler Conveyor Co. v. Commissioner*, 303 F.2d 567, 569 (1st Cir. 1962); cf. *Young v. Commissioner*, 269 F.2d 89, 94 (2d Cir. 1959).

Lanham Act provisions governing trade-mark registration further confirm the accuracy of the parties' own description of their transaction as a license. Under 15 U.S.C. § 1115(a), registration of a trade-mark is *prima facie* evidence of the registrant's exclusive ownership rights; e.g., *American Heritage Life Insurance Co., v. Heritage Life Insurance Co.*, 494 F.2d 3, 10 (5th Cir. 1974); and under 15 U.S.C. § 1060, an assignment of a registered mark may be recorded in the U.S. Patent Office. If an assignment is not recorded within a specified time, however, the assignment is void against a subsequent purchaser for valuable consideration without notice. 15 U.S.C. § 1060. Despite this recording provision, the License specified that the Vogue name would remain registered in taxpayer's name only. JA—18, 85, 107. There is no indication that a document was ever recorded evidencing taxpayer's "assignment" to Butterick of a limited use of the Vogue name. It is inconceivable that Butterick would have bargained for assignment of a valuable mark and name, yet failed to protect itself under 15 U.S.C. § 1060. Obviously, nothing was recorded because, as the agreements indicate, the parties had bargained simply for a license.

If further evidence were needed that the agreements correctly characterized the transaction, it lies in the

parties' own tax treatment of royalties paid under the License. For at least eight tax years, through 1968, taxpayer reported all royalties as ordinary income. Not until 1973, some twelve years after the transfer, did taxpayer belatedly "see the light" and file refund claims for the two years in issue. JA—7-12, 22-23. Butterick, moreover, has uniformly treated these royalties as deductible expenses—i.e. not as consideration for the purchase of the Vogue name. JA—22. See, e.g., *Leisure Dynamics, Inc. v. Commissioner*, *supra*, 494 F.2d 1340, *rev'g*, 32 CCH Tax Ct. Mem. 159. The parties' voluntary tax treatment should be considered as probative of their understanding of the nature of their agreement. See *Redler Conveyer Co. v. Commissioner*, *supra*, 303 F.2d at 569; *Switzer v. Commissioner*, 226 F.2d 329, 330-31 (6th Cir. 1955).

Still further proof that the language of the agreements is consistent with the reality of taxpayer's transaction lies in a comparison of the 1961 agreement with the 1967 agreement. In the later agreement, taxpayer specifically provided for additional quality control restrictions, including the right to inspect all phases of Butterick's operations. JA—100-01.* In addition, the 1967 agreement increased the minimum royalty payments due from Butterick beginning in 1973 from \$1,000 annually to \$25,000 annually; and these minimum royalties had to be paid or taxpayer had a specific right to terminate the agreement. JA—88-89, 110. Both the addition of further quality control restrictions and the substantial increase in minimum annual royalties in the 1967 agreement cannot be satisfactorily reconciled with taxpayer's contention that it sold the limited right to use the Vogue name six years

* The inclusion of further quality control restrictions in 1967 demonstrates taxpayer's awareness that it had granted a license which, under trade-mark law, necessitated inclusion of comprehensive quality control restrictions. See, e.g., *Franchised Stores of New York, Inc. v. Winter*, *supra*, 394 F.2d 664.

earlier, in 1961. *Cf. Whitmore v. Commissioner*, 24 CCH Tax Ct. Mem. 633, 639 (1965).

In the District Court, the taxpayer insisted that over the years it had little or no actual interest in or control over Butterick's use of the Vogue name, an argument which the District Court apparently found of some persuasive value. JA—151-52. The stipulated facts and documents, however, belie taxpayer's claimed lack of interest or control.* Moreover, it seems very doubtful that taxpayer has been as insouciant about Butterick's use of the Vogue mark as it claims, since failure to exercise diligent control could result in cancellation of the registered Vogue mark. *See, e.g., Franchised Stores of New York, Inc. v. Winter, supra*, 394 F.2d at 668. In any event, this Court has previously observed that

the fact that [a transferor] did not exercise some of the rights available to it under the license, and the fact that these rights eventually became worthless . . . are irrelevant to the present inquiry. *We are concerned with the value of the rights retained or transferred at the date of the transfer.* [Emphasis added]

* Even putting aside the quality control provisions, the agreements provided for a close ongoing business relationship between the parties. This is evidenced by taxpayer's acquisition of substantial shares of Butterick stock (JA—37, 51); by the fact that royalties were based on *all* Butterick's sales (JA—84, 105); by taxpayer's agreement to provide free "editorial" space to feature Butterick patterns, despite the substantial cost (JA—20-21, 82-83, 103-04); by taxpayer's promise to provide Butterick free fashion information (JA—83, 104); and by taxpayer's announcement in 1961 that the existing "liaison" between the Vogue pattern people and taxpayer's editorial and art department would be maintained (JA—19). Moreover, the record reflects that, where necessary, taxpayer showed no hesitation in controlling Butterick's use of the Vogue name. JA—121-32.

Allied Chemical Corp. v. United States, supra, 370 F.2d at 699.

The foregoing analysis demonstrates that the reality of taxpayer's transfer conforms to the carefully-chosen words used by taxpayer. This is not a case in which the labels used in the agreements transparently differ from the substance of the transaction. Accordingly, having structured its agreement in a particular manner, this knowledgeable taxpayer should not be permitted to claim that the substance of the transaction differed from its form. The right to look past the carefully-prepared agreements should be reserved only to the Government in order to prevent tax avoidance or protect the public fisc. See *Federal Bulk Carrier, Inc. v. Commissioner*, 558 F.2d 128,130 (2d Cir. 1977); cf. *Commissioner v. Danielson*, 378 F.2d 771, 775 (3d Cir.), cert. denied, 389 U.S. 858 (1967).*

In summary, taxpayer retained many substantial rights to the limited trade name transferred. These retained rights, viewed in the light of the circumstances surrounding taxpayer's transfer, including the plain language of the agreements in issue, compel one conclusion. The pertinent agreements are just what they purport to be—

* The present case amply demonstrates how the Government is prejudiced when a taxpayer carefully drafts pertinent agreements one way and thereafter claims that the substance of the agreement differed from the prepared form. Since 1961 Butterick has obtained a deduction for all royalties paid to the taxpayer (JA—22). Given the language of the License, Butterick's right to take a deduction would have appeared to be beyond dispute. Yet now, years later, taxpayer claims that the transfer had been a sale all along. If taxpayer is correct, Butterick was not entitled to the deductions obtained. See e.g., *Leisure Dynamics, Inc. v. Commissioner, supra*, 494 F.2d 1340, rev'g 32 CCH Tax. Ct. Mem. 159.

merely a license of the Vogue trade name. Taxpayer should not be permitted at this late date to argue otherwise. Capital gains treatment, therefore, is not available to taxpayer.

C. The District Court's Decision to Preclude Capital Gains Treatment Only on Royalties Attributable to Vogue Pattern Sales

In its decision, the District Court limited capital gains treatment to royalties not attributable to Vogue pattern sales. In doing so, the District Court implicitly recognized that the existence of royalties based on use of the transferred name evidenced taxpayer's continuing interest in that transferred asset. See *Moberg v. Commissioner*, *supra*, 365 F.2d 337. Unfortunately, however, the District Court did not go far enough.

Logically, when a court concludes that certain royalties reflect a taxpayer's continuing interest in the transferred asset, the conclusion contradicts any claim that the taxpayer has sold the asset outright (*i.e.* retained no substantial interest in the asset). See Note, 80 Harv. L. Rev. *supra* at 457. Moreover, the dispositive effect of taxpayer's retained interest in the asset is not at all weakened by the fact that, under the transfer agreement, taxpayer *also* receives *other* royalty sums. Accordingly, the District Court seems to have correctly perceived that taxpayer's royalties evidenced a continuing economic interest in the transferred Vogue name. But it should have taken the extra, logical step and concluded that, given this retained interest, taxpayer's transfer had be viewed as a mere license, precluding *any* capital gains treatment.

CONCLUSION

By reason of the foregoing, the judgment and amended judgment of the United States District Court should be vacated and this matter remanded to the District Court with instructions to enter a judgment dismissing taxpayer's complaint, with prejudice.

Dated: New York, New York
December 12, 1977

Respectfully submitted,

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AFFIDAVIT OF MAILING

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County of New York)

William G. Ballaine being duly sworn,
deposes and says that he is employed in the Office of the
United States Attorney for the Southern District of New York.

That on the
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12th day of December 19 77
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And deponent further says he sealed the said envelope and placed the same in the mail chute drop for mailing in the United States Courthouse Annex, One St. Andrews Plaza, Borough of Manhattan, City of New York.

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12th day of December, 19 77

Pauline B. Troia
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Commission Expires March 30, 1978

William H. Ballaine

